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The Conference Board

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Economic Times

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Editor's Note

Last month we went to the theatre, this month it's South America. What we learned is found in the adjoining piece and on *page 5*. Another important focus this month is the S&L debacle, which is the subject for our Colloquium *(next page)* and for Ellis T. (Bud) Gravette, Jr., and myself *(page 4)*. (Bud is Chairman of Ardath Associates in La Jolla and former Chairman of the Bowery Savings Bank here in New York.) You'll enjoy, I'm sure, two quotable quotes with somewhat different points of view about the international competitive position of the United States *(page 6)*. We also offer the regular *Conference Board Stat File*, preceded by the first in a series of "Statistical Insight" columns by our distinguished colleague, Al Sommers.

In September, about half the copies of *Economic Times* will arrive wrapped in a separate cover that will contain a return card, designed so that you can let us know whether or not you want to continue on the distribution list, report any change of address, etc. There will also be room for comments, which we hope you will take advantage of.

Maxim of the month:

Forecasting the future is fraud with peril.

Apologies to the *Dallas Morning News*

No Pain, No Gain

Although the world's attention has been focused on the USSR and Eastern Europe lately, the shift to the economic right in Latin America has been equally dramatic. Everywhere you look, from Del Rio to Tierra del Fuego, revolution is underway. Yes, revolution! For Latin America, however, it is an entirely atypical revolution: nonviolent, democratic and libertarian.

The details of and the degree of commitment to these economic revolutions differ from country to country, but the main themes are common: In each country the design is to increase the standard of living and to stop inflation by:

- Shrinking the budget deficit
- Curtailing government payrolls
- Enforcing the tax code
- Eliminating subsidies
- Privatizing government-owned industries
- Deregulating private industry
- Ending price and wage controls
- Opening the economy internationally

The plans seem sensible, the politicians sound sincere, and the special-interest groups whose oxen are being gored are at least partially subdued. Furthermore, early policy initiatives, some of them extraordinarily bold — such as new President Collor "kidnapping" two-thirds of the money Brazilians kept in banks — have been encouraging. Mexico, perhaps, is farthest along. But these initiatives, important as they are, are only the beginning. Most of the really tough decisions have yet to be taken. It is, for example, relatively easy to announce that a government-owned railroad is to be privatized, it is a lot less easy to decide who are to become the new owners and under what terms. But what is really difficult is for the government to acquiesce when the new owners discharge 10,000 redundant employees!

It is not clear that the fragile structure of democracy in place throughout most of Latin America can withstand the pressures generated by the real-life consequences of innocent-sounding policy prescriptions such as "eliminate inefficient subsidies." As the Soviet people told Gorbachev recently: Oh yes, we want the economy modernized, but don't you dare raise the *(absurdly low)* price of bread in the process.

The inconsistency is obvious. Voters elect their political leaders to maximize pleasure and minimize pain. That's where all the subsidies, the bloated federal payrolls, and the inflation came from in the first place. But, when carried too far, a high and growing standard of living is also sacrificed , as the Argentine data on page 5 so vividly demonstrate. The problem boils down to this:

> **Economic progress requires change. Change means pain. No pain, no gain. But in democracy, pain is against the rules.**

This is the central issue of democracy: to reconcile that dilemma. Currently, the pendulum is swinging to the right everywhere south of the border. Whether the swing will carry through a full arc all the way to a high degree of economic efficiency with liberty is still to be tested. Prospects are better today than in a long time. But don't hold your breath, and don't bet the hacienda. How it will come out is not at all clear.

Ed Fiedler

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Colloquium

Background:

The focus of S&L debacle has shifted recently to the inter-regional transfer of wealth that arises from the concentration of thrift bankruptcies in the Southwest. The contention is that other states are paying $500 to $1000 per resident to bail out the Southwestern states, and thus that the latter gain an economic windfall at the expense of the rest of the nation, where the strength of the economy is correspondingly sapped.

Question:

Is this transfer of wealth something that should seriously concern the other states?

Albert M. Wojnilower
First Boston Corporation

To fund the bailout, the government sells securities worldwide. The proceeds go to reimburse S&L depositors and acquirers, many not from the Southwest and all essentially free to invest anywhere. The net regional effect is obscure and likely small.

When oil prices were controlled in the 1970s, the country benefited at the Southwest's expense. Only if now we had to pay higher taxes, as opposed to voluntarily buying securities, would the tables be turned.

Charls E. Walker
Charls E. Walker Associates

Concern might be justified if residents in the disaster states had caused the S&L debacle. But in fact the root cause was 55 years of lax legislation by the U.S. Congress and lax regulation by the agencies Congress created and oversaw. The S&L debacle is therefore a national problem. It should be treated on a national basis with all necessary funds coming from the nation's taxpayers.

Don Conlan
Capital Strategies Research, Inc.

A replay of King Solomon's dilemma with the same dire potential. This debate compounds a double felony; i.e., excessive deposit insurance in the first place and then the bailout. Red dye monitors on capital flows? Okay, how do Maryland and Virginia benefit from the presense of the Federal government, the Midwest from crop supports, etc. Forget it! Adam Smith lives! Capital flows to the best opportunities, regardless of location, and benefits accrue to the entire society. Don't let politicians put the invisible hand in the till!

Stephen H. Axilrod
Nikko Securities International

As a nation, we should be most concerned about learning from and not repeating the mistake that got us into the present mess. The bail-out's cost rose from merely extravagant to colossal because policy-makers refused to face the problems early and papered them over (literally so if you consider how capital deficiencies were often covered). Deposit insurance is desirable and kept the crisis from spreading, but the potential size of wealth transfer indicates the need for reform.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Director, Economic Studies Program, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Visiting Professor, Harvard University; Charls E. Walker, Chairman, Charls E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Where Did All the S&L Money Go?

By Ellis T. Gravette, Jr., and Edgar R. Fiedler

Most of the money went not to the fat-cats, but to honest, ordinary, everyday people

By now the thrift-industry debacle has been thoroughly documented and even, occasionally, well analyzed. There are still some misconceptions around — for example, that deregulation was a major cause of the problem, and that it is the industry *(rather than the depositors)* that is being bailed out. But these myths are gradually fading. And the main culprits have been accurately identified as the head-in-the-sand politicians in Congress, the Executive Branch and the Federal Home Loan Bank Board, plus a goodly number of corrupt or incompetent S&L operators.

The greatest remaining confusion is: What happened to all that money? Some popular accounts imply, as Massachusetts Senator Kerry did recently, that most of it was stolen by fraudulent operators, who have stashed it in untraceable offshore bank accounts. Yes, that did happen in more than a few cases totaling tens of millions, *maybe* even hundreds of millions of dollars. Big money by most standards, yes, but very small potatoes compared with the hundreds of *billions* — about $2,000 per U.S. household — lost by the S&Ls.

Well, where did the big money go? Although many people will be reluctant to accept this thought — because it's not a conspiracy theory — the answer is surprisingly simple. Most of the money was paid out in a multitude of honest, ordinary, everyday business transactions to two groups: First, to thrift depositors, especially those buying "jumbo certificates" from unprofitable thrifts offering above-market interest rates in a scramble to bring in enough new deposits to offset their losses — but also to depositors at profitable thrifts that were forced to compete with the fly-by-nights. All these depositors received excessive interest returns on their deposits, that is, higher interest rates than would have prevailed in a normal market. In total, massive amounts.

Second, the money went to everyone involved in the development of the high-risk real-estate projects financed by those imprudent loans made by the S&Ls — that is, to those who sold property to the developers, often at inflated prices, and then to all the contractors, bulldozer operators, plumbers, lumber warehouses, and other suppliers involved in the project. Again, in the aggregate, enormous sums.

The big money, in other words, went to ordinary Americans, indeed, to a fairly substantial fraction of the American people. It didn't go just to the wheeler-dealers and the fat-cats, but also to — well, do you remember your frugal Aunt Edith who always scanned the ads to find the highest insured interest rate for her nest egg? And your happy-go-lucky brother-in-law, the electrician, who was always taking off for Texas or wherever to work on some new construction project? They were among those who got the "big money," bit by bit. And that puts an ironic twist on the story, because it means that in the end the money went to many of the same people who, as taxpayers, are now going to have to pony up to set the whole mess right.

Argentina's Economic Tragedy

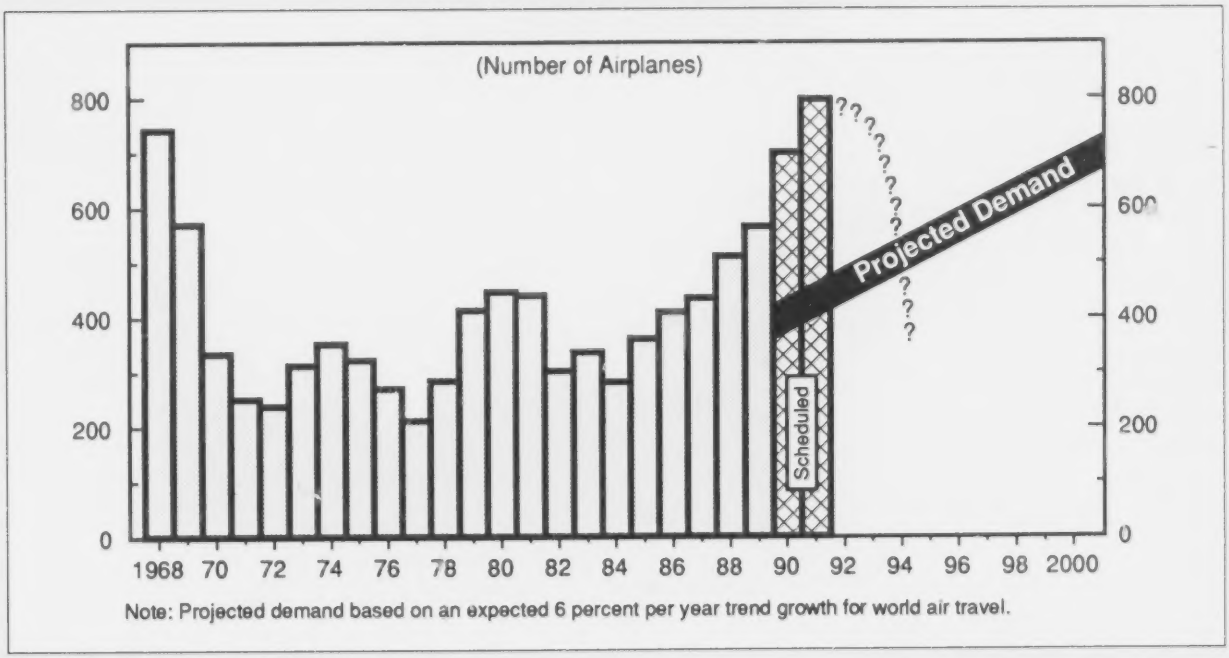
	1930	1989
Per Capita Output (U.S. 89$)	$ 3,700	$ 1,800
World Ranking	7th	70th
Economic Growth (annual rate, 10 years ending)	5%	-0.8%
Inflation Rate	2%	4923%
Government Spending (% of GDP)	11%	45% ('88)

Data compiled by ALPHA Estudio de Economia y Negotios S.A., Buenos Aires.

Comment: **These data show the dramatic consequences of sixty years of political and economic mismanagement, proving again the adage that Argentina was "blessed by nature but condemned by ideology."**

Present Boom, Coming Bust

Commercial Aircraft Deliveries



Note: Projected demand based on an expected 6 percent per year trend growth for world air travel.

Comment: Commercial aircraft manufacturers around the world are enjoying good times these days. New orders are flooding in. Production is at full capacity. Profit margins are gratifyingly high. And unfilled order backlogs are at levels that appear to guarantee continued prosperity for years to come. But watch out! As the manufacturers themselves realize, it is too much of a good thing. Much too much! The frenzied ordering by the airlines has pushed current levels of production far beyond the long-term needs of the industry. Indeed, almost twice as many planes are to be delivered next year as called for by reasonable estimates of long-term travel growth. Sometime after 1991, then, aircraft production will have to return to reality. Today's boom, inevitably, will become tomorrow's bust. Let's hope it's not as painful for the manufacturers and their suppliers as the 1968-72 cycle proved to be.

Quotable Quotes

Baseball and Imperial Overstretch

By George F. Will

The national pastime is better than ever in almost every way and is getting even better every year. The same can not be said about the nation. America consumes too much and saves too little. Indeed the nation's savings rate, the worst among industrial nations, is a scandal because it is a choice: Public policies contribute to it. Small savings and huge government deficits cause underinvestment, which causes slow growth of productivity, which produces economic anemia and uncompetitiveness. Increasingly we are being outperformed by—and even owned by—our competitors. We should be chagrined, but not surprised. They are studying harder and longer, and working harder and longer and better than we are. From a population approximately one-half the size of ours, Japan is producing an equal number of engineers. In 1985, 55 percent of U.S. doctoral degrees in engineering were awarded to foreign nationals, many of whom went home. In the late 1980s about half the Ph.D.s being hired in the high-tech electronics industry were foreign born. We produce 35,000 lawyers a year. Japan muddles through with only a fraction of that depressing total. American children spend 180 days in school, Japanese children spend 240 days and the school days are longer. Japanese students outperform American students in math, science and engineering. American children outperform Japanese in English. For now.

Such facts have given rise to a spate of analyses, the theme of which is that America's problems are the result of "imperial overstretch," a national impulse to try to do too much abroad. I believe America's real problem is individual understretch, a tendency of Americans to demand too little of themselves, at their lathes, their desks, their computer terminals. The baseball men I have spent time with while preparing this book demonstrate an admirable seriousness about their capabilities…If Americans made goods and services the way [Baltimore shortstop] Ripken makes double plays, [San Diego outfielder] Gwynn makes hits, [Los Angeles pitcher] Hershiser makes pitches and [Oakland manager] La Russa makes decisions, you would hear no more about the nation's trajectory having passed its apogee.

(Excerpted from George F. Will, *Men at Work — The Craft of Baseball*, Macmillan, New York, 1990.)

Europe and America: Who's Number One?

By Ben J. Wattenberg

In the 1980s it was said that Japan and Europe were in ascendant phases and that America would no longer be number one, whatever that meant. No nation or group of nations can be dominant in the modern world unless it is technologically advanced, populous, prosperous, market-oriented, freely governed, and militarily secure. Japan, for all its economic might and technological achievement, is not. It is the most rapidly aging country in the world, a distant island defended by the United States. It is not in the running for global superpower. That leaves Europe and the United States.

Let us assume the best and hope all good things happen in Europe. By the year 2000, Eastern and Western Europe will have come together in a loose political union with freedom, markets, and a common currency. It will still have nineteen different national tongues, different cultural and religious traditions, and a shrinking population.

There will be continued illegal immigration to the Continent from Africa and Asia and vigorous efforts to resist it. The result may be the worst of two worlds: small population gains and great internal tension.

While Europe and Japan will be declining, the United States will be growing. The babyboom infants of yesteryear are the mothers of today. Our country accepts more immigrants than the rest of the world and thus provides itself with a renewed infusion of intellectual dynamism. (Of the forty Westinghouse science scholarship winners in 1990, nineteen were Asian-American.)

There is only one modern, growing, stable, large, democratic, capitalist nation with a close-to-perfect investment climate: the United States. In the years to come, American values will continue to play a leading role in the emerging free world.

(Excerpted from Ben J. Wattenberg, *The First Universal Nation: Leading Indicators and Ideas About the Surge of America in the 1990s*, forthcoming. Ben Wattenberg is Senior Fellow at the American Enterprise Institute.)

Albert T. Sommers' Statistical Insight

The U.S. International Investment Position

Albert T. Sommers
Senior Fellow and
Economic Counsellor
The Conference Board

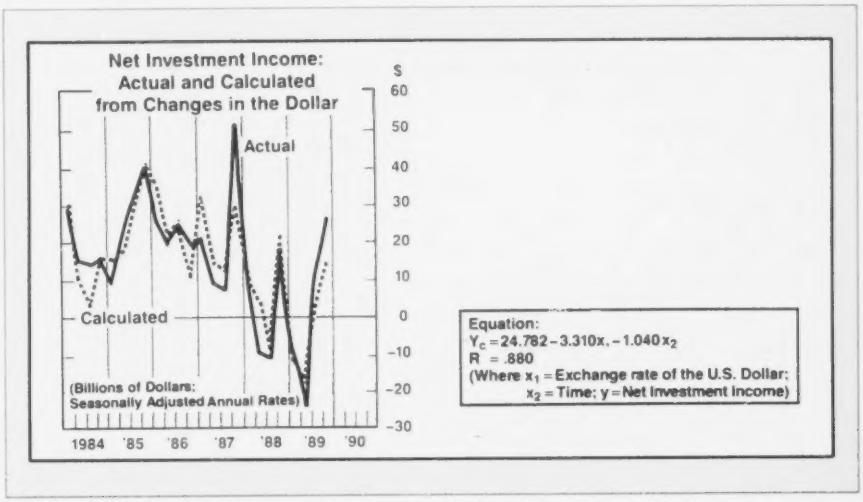
In all the bewildering array of statistics on the U.S. net international position, the most widely publicized figure points to a massive U.S. international indebtedness — that is, an excess of foreign investment in the United States over U.S. investment abroad. The standard accounting for this international balance sheet tells us that as a consequence of persistent large deficits in the U.S. international accounts, and therefore persistent growth in foreign holdings of dollars, the net investment position of the United States has swung from about a $100 billion surplus at the beginning of this decade to about a $600 billion deficit today.

This accounting seems to be inconsistent with the fact that U.S. earnings from its investment abroad have persistently exceeded earnings of foreigners on their investment in the U.S. The net earnings balance has subsided, but it was slightly positive even in 1989. How come? Well, for one thing the U.S. net indebtedness is not as big as it looks; for another, its net earnings are not as good as they look.

All of these statistics have prominent wrinkles in them, wrinkles that should be straightened out to achieve a clearer picture of what's at work in the international investment market. In the first place, the net indebtedness of the United States, as shown in the standard table, is open to one major correction. The direct investments in both the U.S. account and the foreign account are expressed in terms of book value; but the U.S. investment abroad is, on average, much older, and its appreciation over time (which is unrecognized in the accounts) is doubtless much greater than the comparable appreciation for foreign investment in the U.S. If the two sets of figures were converted from book value to current-market value, the statistical scholars on this subject argue that the U.S. net investment position would be increased by as much as $500 billion. Such an adjustment would nearly wipe out the net indebtedness, and would help to explain why the net earnings position has not subsided into substantial deficit.

But other factors that enter into the flows of earnings here and abroad suggest a less comforting conclusion. The U.S. excess of receipts of earnings over payments of earnings has in fact fallen very sharply since 1985, but the plunge has been periodically interrupted, now and then spectacularly, by sudden surges of income. This happened toward the end of each of the past 3 years. These surges of net earnings reflect the translation of profits earned by U.S. subidiaries abroad, at points in time when the dollar has weakened and therefore the earnings of these subsidiaries in foreign currencies translate into much higher earnings when expressed in dollars. The earnings balance has in fact deteriorated, and the deterioration is well revealed by the accompanying chart, which expresses the change in net investment income as a function of changes in the dollar, and time.

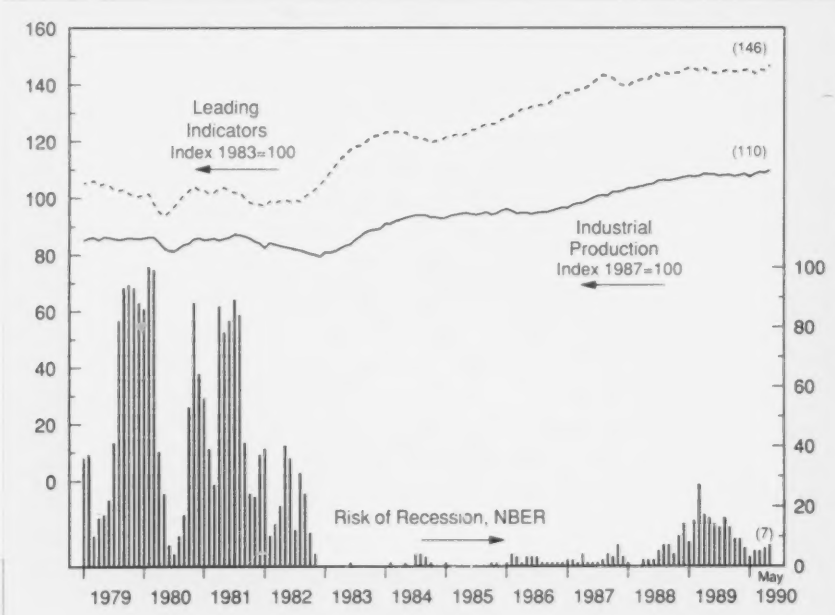
When we smooth the translation gains and losses, the change in U.S. net investment income is much clearer: It has been subsiding ever since the early 1980s, at an average rate of about $4 billion a year. This is not a big figure relative to the trade deficit, which is now running at about $100 billion a year. But the accumulating loss since the beginning of the decade has cost the U.S. international account about $40 billion — that is, the $40 billion annual surplus earned on net investment in the late 1970s has fallen to zero. Foreign investment in the United States has many favorable consequences; but the flow to foreigners of earnings on those investments is itself a source of weakness in the U.S. international current account now. And almost assuredly, it will continue to reduce our current-account balance for the next several years.



Conference Board Stat File

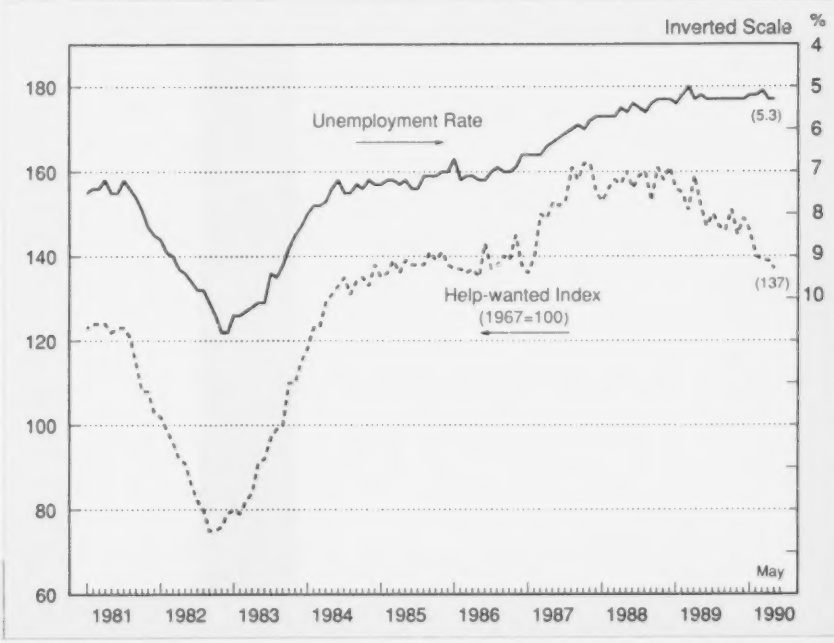
What's impressive about the economy is how much stability the statistics display *(discounting the usual short-term noise)* month after month, and thus how minutely the outlook changes. All journalists and most economists find this stability devastatingly frustrating, but it's been true for a year and a half and there's no sign of change this month either. We continue to look for 2 percent growth, 4-5 percent inflation, and fairly stable financial markets indefinitely, that is, until the business cycle awakes and rears its ugly head in one direction or the other. *(Note: Data for Conference Board series in this section are available upon request to Ken Goldstein at 212-339-0331.)*

Early Warning Indicators



Economy advancing slowly. Recession chances remote.

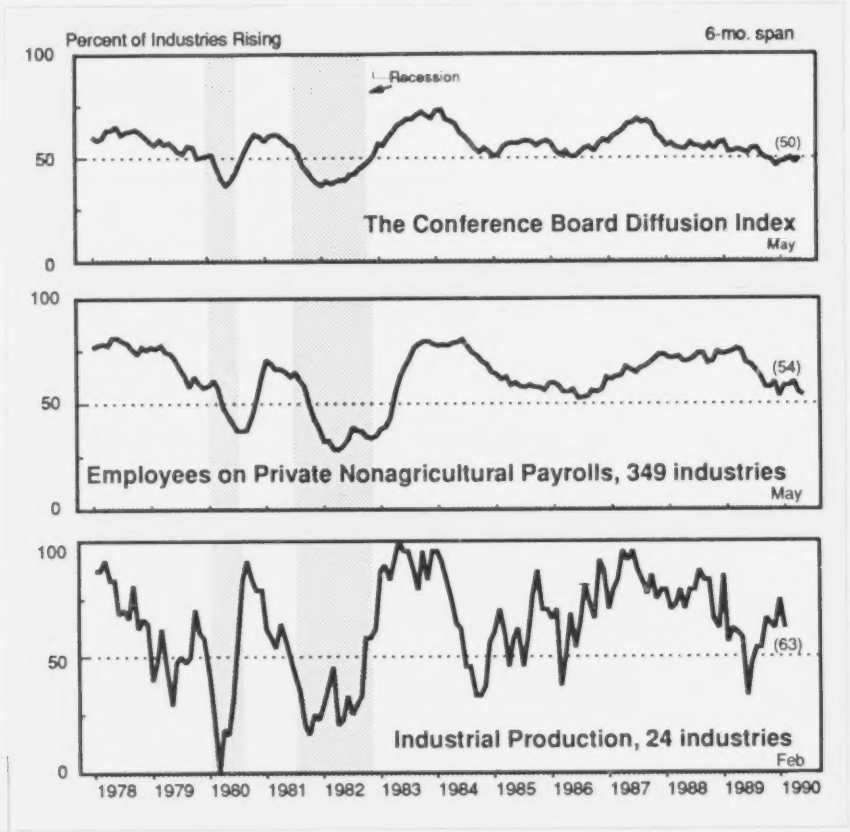
Help-wanted Advertising and Unemployment



Labor demand softening.

Conference Board Stat File

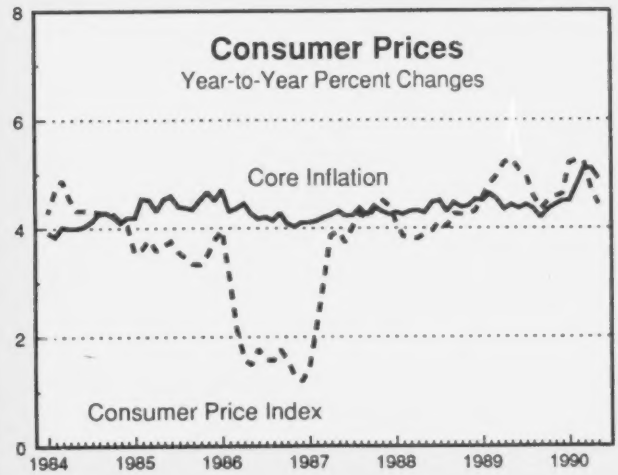
Indexes of Economic Momentum



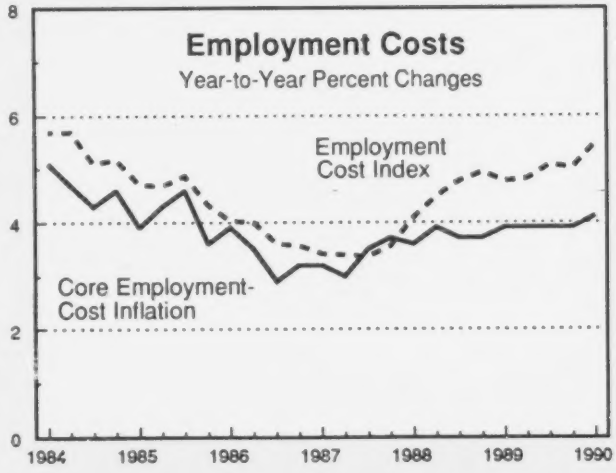
Momentum holding slightly above the water line.

Just a hint of acceleration.

Inflation Fundamentals



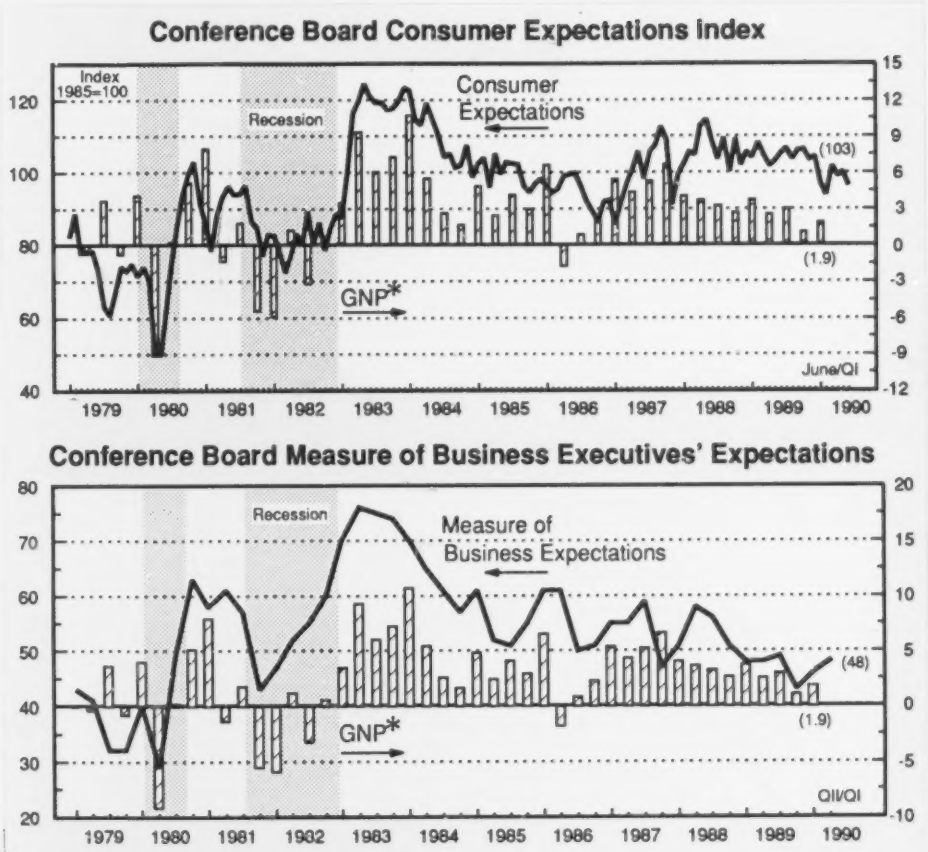
Core inflation = CPI excluding food at home and energy



Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e.,excluding the benefits that are part of the ECI)

Conference Board Stat File

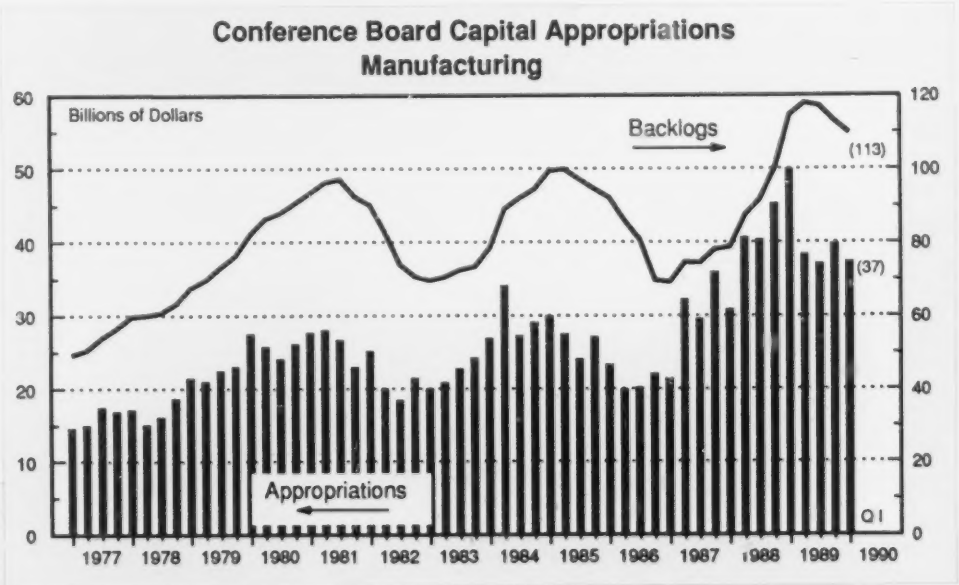
Confidence



* Quarterly percent changes in GNP at annual rates

Both measures still consistent with slow economic expansion.

Investment Intentions



Both series signal some loss of energy in manufacturers' capital expansion plans.

Inside the Crystal Ball

		UCLA	MERRILL L.	DUPONT	GEORGIA ST.	CONF. BOARD	L.H. MEYER	DRI	WEFA		
Date of Forecast		May	May	May	May	May	May	May	May		
Gross National Product											
(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)											
		%	%	%	%	%	%	%	%		
Actual	1989 4Q	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4Q 1989	Actual
	1990 1Q	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1Q 1990	
Forecast	2Q	2.5	2.1	1.5	1.2	3.6	1.9	3.2	2.8	2Q	Forecast
	3Q	1.1	1.9	1.9	3.2	3.7	1.7	2.2	1.7	3Q	
	4Q	1.7	1.5	2.1	1.5	2.8	1.2	1.4	1.9	4Q	
	1991 1Q	2.6	1.7	2.1	3.1	1.8	1.8	2.7	2.5	1Q 1991	
	2Q	2.4	2.3	2.5	1.7	1.2	2.5	2.3	2.4	2Q	
	3Q	2.3	2.4	3.0	2.0	1.1	2.4	2.1	2.1	3Q	
	4Q	2.4	2.5	2.8	0.2	2.7	2.7	1.3	2.4	4Q	
	1992 1Q	2.5		3.1		3.8	2.9	1.9	2.4	1Q 1992	
	2Q	2.1		3.4		2.4	2.6	2.2	2.3	2Q	
Inflation (GNP Deflator)											
(Percent change from same quarter one year earlier)											
Actual	1989 4Q	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	1989 4Q	Actual
Forecast	1990 4Q	4.5	4.4	4.1	4.3	4.8	4.3	4.0	4.4	1990 4Q	Forecast
	1991 4Q	4.1	4.2	3.9	4.3	4.7	4.0	4.0	4.1	1991 4Q	
Unemployment Rate											
(Percent, quarterly)											
Actual	1989 4Q	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	4Q 1989	Actual
	1990 1Q	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	1Q 1990	
Forecast	2Q	5.6	5.3	5.4	5.4	5.3	5.5	5.4	5.5	2Q	Forecast
	3Q	5.8	5.4	5.4	5.4	5.3	5.6	5.3	5.7	3Q	
	4Q	5.9	5.5	5.5	5.4	5.3	5.8	5.4	5.8	4Q	
	1991 1Q	5.9	5.5	5.6	5.5	5.3	5.8	5.4	5.8	1Q 1991	
	2Q	5.9	5.4	5.5	5.6	5.3	5.8	5.4	5.8	2Q	
	3Q	5.9	5.4	5.4	5.6	5.3	5.8	5.4	5.8	3Q	
	4Q	5.8	5.4	5.3	5.5	5.3	5.8	5.5	5.7	4Q	
	1992 1Q	5.7		5.2		5.3	5.7	5.5	5.6	1Q 1992	
	2Q	5.7		5.2		5.3	5.7	5.5	5.6	2Q	

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